Before the
Federal Communications Commission
Washington, D.C. 20554

In the matter of	)	
	)	
Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers	)	CC Docket No. 00-256
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation	)	CC Docket No. 98-77
Prescribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers	)	CC Docket No. 98-166

REPLY COMMENTS OF VALOR TELECOMMUNICATIONS ENTERPRISES, LLC

Valor Telecommunications Enterprises, LLC ("Valor") submits the following Reply Comments in response to the Further Notice of Proposed Rulemaking ("FNPRM") issued in the above-captioned proceedings on November 28, 2001.[1]

Valor is a private start-up company, formed for the purpose of purchasing approximately 550,000 mostly rural access lines from GTE (now Verizon) in Arkansas, Oklahoma, Texas and New Mexico. In 2002, Valor acquired Kerrville Communications, Inc., whose wholly-owned subsidiary Kerrville Telephone Company also serves rural customers in Texas. Since acquiring

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[1] *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers,* CC Docket No. 00-256, Second Report and Order and Further Notice of Proposed Rulemaking in CC Docket No. 00-256, Fifteenth Report and Order in CC Docket no. 96-45, and Report and Order in CC Docket nos. 98-77 and 98-166, FCC 01-304, 16 FCC Rcd 19613 (2001) ("FNPRM").

its rural exchanges, Valor has made significant investments that have allowed it to offer its customers new and improved services.

As a mid-size independent incumbent local exchange carrier ("LEC") whose interstate access service prices are regulated under the FCC's price cap rules, Valor joins the many commenters in this proceeding that have urged the Commission to eliminate the all-or-nothing rule.[2] Furthermore, Valor supports the position of ALLTEL, CenturyTel, Madison River Communications, and TDS's Joint Comments on the MAG plan. Valor urges the Commission to give price cap carriers currently regulated under the CALLS mechanism the ability to opt into the MAG plan if that form of regulation is better suited to the needs of the carrier. Finally, the FCC should resist efforts of interexchange carriers to force a mandatory, burdensome price-cap like regulatory scheme on mid-size carriers.

DISCUSSION

I. The Commission Should Immediately Eliminate The All-Or Nothing Rule.

In their comments, AT&T and WorldCom argue that the all-or-nothing rule should be retained. AT&T suggests that rate-of-return regulation is inappropriate in most cases, and further asserts that the all-or-nothing rule is necessary in order to prevent "cost-shifting" and "gaming" by LECs. WorldCom suggests that the rule is necessary because rate-of-return carriers are subject to "relaxed" accounting rules. As explained below, none of these arguments have any merit.

A. Both Price Cap and Rate-of Return are Legitimate Forms of Regulation for Mid-Size Carriers.

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2 *See, e.g.* Comments of ALLTEL Communications, Inc., CenturyTel, Inc., Madison River Communications, LLC, and TDS Telecommunications Corporation at 23 ("Joint Comments"); Comments of Verizon ("Verizon Comments"); Comments of Puerto Rico Telephone Company, Inc. ("PRTC Comments"); Comments of the Independent Telephone & Telecommunications Alliance ("ITTA Comments"); Comments of the ICORE Companies ("ICORE Comments").

The FCC has already established that price cap and rate-of-return are both appropriate forms of regulation for mid-size carriers. When the Commission adopted its initial regulatory framework for price cap regulation, it considered whether to subject mid-size carriers to mandatory price cap regulation and concluded that, unlike the RBOCs and GTE, mid-size carriers should be given the flexibility to *elect* price cap regulation given the size and scope of their operations. In doing so, the FCC recognized that the effect of price caps on individual mid-size carriers was uncertain given their "considerable diversity,"[3] and therefore no one form of regulation could meet the needs of all mid-size carriers.[4] Taking this reasoning one step further, mid-sized carriers that serve predominately rural access lines have "considerable diversity" among the study areas that they serve, making the requirement to chose one form of regulation for all study areas burdensome. Many rural study areas, because of cost, density or demand characteristics, are not suitable for current forms of price cap regulation. As mid-size carriers acquire rural access lines from price cap carriers, these carriers need the flexibility to assess which form of regulation would best serve the investment requirements and customer needs of those newly acquired study areas.

B. The Problems the All-Or-Nothing Rule Is Designed to Prevent Are Merely Speculative and Can Be Prevented by Existing Safeguards.

The FCC initially adopted the all-or-nothing rule in order to address two types of undesirable potential behavior by price-cap LECs: "cost shifting" from a price cap affiliate to a non-price cap affiliate, thereby increasing the profits of the one and the rates of the other; and "gaming the system" by switching back and forth between rate-of-return and price cap

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[3] *Policy and Rules Concerning Rates for Dominant Carriers,* Second Report and Order, 5 FCC Rcd 6786, 6818 ("LEC Price Cap Order"). *See also* Joint Comments at 23-24.

[4] Joint Comments at 23-25.

regulation.[5] Experience has not served to justify either rationale. Because other existing safeguards can adequately prevent LECs from engaging in these behaviors, the all-or-nothing rule is no longer needed.

1. Cost-Shifting Concerns are Entirely Speculative, Have Been Unsupported by Recent Experience, and Already Are Addressed by Other Safeguards.

When the FCC adopted the all-or-nothing rule in the *LEC Price Cap Order,* it recognized that the cost-shifting justification for the rule was entirely speculative. The Commission sought to "prevent" cost shifting out of an "abundance of caution" because LECs "might" be able to shift costs by improperly allocating costs associated with the price cap affiliate to the rate of return affiliate's rate base.[6] In the *FNPRM,* the Commission asks whether circumstances have changed since it first considered the rule.[7]

Real world experience has provided the Commission with no evidence that supports retention of the all-or-nothing rule. Since 1999, when a price cap carrier first began operating with a rate-of-return affiliate, the Commission has issued a limited number of waivers to carriers without imposing any additional safeguards to prevent cost-shifting.[8] The record shows that these waivers generated no evidence of cost-shifting: carriers receiving waivers have engaged in no improper behavior, and nothing indicates that the absence of the rule encourages cost-shifting.[9]

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5 *FNPRM,* 16 FCC Rcd at ¶ 261.

6 *LEC Price Cap Order,* 15 FCC Rcd at 6819.

7 *FNPRM,* 16 FCC Rcd at ¶ 267.

8 *See* Verizon Comments at 4.

9 Joint Comments at 27-28; ITTA Comments at 3-4.

Moreover, under current FCC rules, any carrier attempting to engage in illegal cost shifting would likely be detected both by the Commission and by its access customers. Even in the absence of the all-or-nothing rule, adequate safeguards exist to prevent such behavior.[10] Separate accounting books are already kept for each study area, enabling regulators to easily detect cost-shifting activity. Overhead costs, the primary type of costs to be allocated, are typically apportioned among study areas through objective measures such as the relative amount of revenues, assets, employees, or access lines. Furthermore, the Commission has a number of enforcement tools at its disposal, including civil penalties, to counter any attempt at cost-shifting were it ever to occur.[11] Should such an attempt materialize, the FCC should rely on its enforcement authority, if necessary, rather than imposing prophylactic rules that seek to deter behavior that has not occurred in the past and is unlikely to occur in the future.

Similarly, AT&T's comments illustrate that concerns about cost-shifting are entirely speculative. Although AT&T insists otherwise, it does not cite a single instance of improper behavior in its comments. Its principal argument consists of the Commission's statement when it first adopted the all-or-nothing rule – over ten years ago – that, in theory, LEC holding companies *could* engage in cost-shifting.[12] AT&T provides no evidence that this theory is still valid today. Likewise, AT&T's assertion that the Commission's jurisdictional accounting rules are insufficient to monitor and protect against cost-shifting is unsupported. Both the FCC and states have the means and the interest to monitor ILEC accounting and enforce the rules through their tariff review and investigation procedures.

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10 Joint Comments at 39-32; PRTC Comments at 10-12; Verizon Comments at 5.

11 47 U.S.C. § 501, *et seq.*

12 AT&T Comments at 16-17.

WorldCom's assertion that "[r]ate of return carriers are, in general, subject to relaxed oversight of their accounting practices" is also simply untrue with respect to mid-size carriers.[13] Interexchange carriers are actively involved in the annual tariff review process and have not hesitated to bring perceived issues in mid-size rate-of-return carriers' accounting practices to the attention of the FCC.[14] For example, a petition by AT&T in the last tariff review process led to a five-month suspension of the tariff of one mid-size rate-of-return carrier.[15]

2. The Commission's Speculative Gaming Concerns Can Be Addressed by Methods Other than the All-Or-Nothing Rule.

Like the cost-shifting rationale, the gaming rationale for the all-or-nothing rule is speculative and is unjustified in today's business climate. Gaming as envisioned by the Commission[16] – *i.e.* "fattening up" on costs under rate-or-return regulation, then "slimming down" under price caps – requires seriously risky mismanagement on the part of the carrier, an irrational move given the need to meet shareholder expectations in today's business environment. Moreover, in order to engage in gaming, a carrier would have to take very public actions related to its prices and USF support, and time intensive steps, such as refiling its tariffs. This scrutiny and cost will deter gaming in the real world. Furthermore, the combination of the objective allocation of overhead costs and the current freeze in the jurisdictional separations

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13 WorldCom comments at 4.

14 Joint Comments at 31.

15 *In the Matter of 2002 Annual Access Tariff Filings,* Memorandum Opinion and Order, 16 FCC Rcd 13123 (2001).

16 *FNRPM* at ¶ 261.

factors[17] provides an additional constraint on such behavior, by limiting a carrier's ability to misallocate costs under rate-of-return regulation.

Given that carriers are unlikely to engage in gaming, no other rationale remains for limiting carrier choice between the two legitimate types of regulation. As explained above, the Commission has recognized that it is fully appropriate for mid-size carriers to be able to choose between price cap and rate-of-return regulation. A carrier should be able to change to a different regulatory framework if circumstances change so as to make it appropriate (*e.g.* because it wishes to make improvements to its network in order to provide advanced services). From a policy standpoint, no justification exists for forcing mid-size carriers to elect between the two forms permanently.

However, to address any lingering concerns about potential gaming, the FCC could require LECs to make a new one-time election for each study area, similar to that which the Commission has previously approved for the Puerto Rico Telephone Company.[18] Valor proposes that carriers also be permitted to subsequently switch to another regulatory mechanism after making this one-time election upon a showing that the change is in the public interest (*i.e.* that the LEC is not engaged in behavior harmful to ratepayers). Allowing a limited ability to change regulatory mechanisms is necessary to ensure that future investment in rural infrastructure and deployment of advanced services for rural communities is not unduly impeded. The combination of the one-time election procedure and the public interest showing justifying changes provides an adequate mechanism to address the speculative concerns that gave

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17 *Jurisdictional Separations and Referral to the Federal-State Joint Board,* Report and Order, 16 FCC Rcd 11431 (2000).

18 PRTC Comments at 11-12; Verizon Comments at 5.

rise to the gaming concern. For the foregoing reasons, the all-or-nothing rule should be eliminated.

II. The Commission Should Give Price Cap Carriers In CALLS The Ability To Opt Into The MAG Plan If That Form Of Regulation Is Better Suited To The Size Of The Carrier.

A. Incentive Regulation Should be Realistic and Optional.

Valor supports the Joint Commenters' formulation of an incentive plan for rate-of-return carriers. At a minimum, any incentive regulation plan should be optional on a study-area-by-study-area basis over a five-year transition period, and any such plan should be tailored to the needs of rural carriers and smaller markets, promote investment in rural infrastructure, and support pricing flexibility.[19] As a natural extension of revoking the all-or-nothing rule and moving toward incentive regulation, the Commission should allow price cap carriers currently operating under the CALLS rules the ability to opt into the MAG plan if that form of regulation is better suited to the needs of the carrier. As explained above, the FCC has already recognized that mid-size carriers should be able to choose between price-cap and rate-of-return regulation because of the considerable diversity among such carriers. Giving mid-size price cap carriers currently operating under CALLS the ability to opt into the MAG plan will result in significant public interest benefits. It will enhance innovation, expansion, and competition among carriers by enabling significant infrastructure improvements that are not feasible under the current regulatory framework.[20] Investment in modern networks capable of supporting advanced services requires extraordinary cost outlays that smaller companies do not have the scale economics to absorb under a price-cap regime. The ability to opt into the MAG plan, by basing

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19 Joint Comments at 3-8, 33-54.

20 *See* ICORE Comments at 14-15.

rates on costs, will enable mid-size carriers such as Valor to invest in infrastructure improvements that will bring new and innovative services to rural consumers.

B. The FCC Should Refuse to Adopt the IXCs' "Price Cap" Provisions.

The FCC should reject IXC efforts to transform incentive regulation under the MAG plan into a full price cap system. Many of the proposals put forth by the AT&T, WorldCom, and Sprint[21] are completely inappropriate for rate-of-return carriers – for example, the 10 percent X-factor proposed by AT&T.[22] Because any incentive regulation plan should take into account the diversity among smaller carriers and the unique cost challenges that they face, the Commission should reject these proposals and adopt a plan that more closely fits the particular needs of rate-of-return carriers.

21 *See* AT&T Comments at 13; WorldCom Comments at 2; Comments of Sprint Corporation at 4.

22 *See* AT&T Comments at 10.

CONCLUSION

For the reasons stated above, Valor urges the Commission to eliminate the all-or-nothing rule, and to give price cap carriers currently regulated under CALLS the ability to opt into the MAG plan.

Respectfully submitted,

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